

## WHAT IS A COOPERATIVE?\*

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A cooperative is a business enterprise--one organized, owned, and controlled by people who have joined together voluntarily to provide themselves with needed supplies and services.

Cooperatives are a part of the American free enterprise system. Cooperatives as a way of doing business go back to Colonial days when neighbors helped each other clear land, build roads, and harvest crops. About 1810, farmers in Goshen, Connecticut, experimented with cooperative dairy marketing and around 1900 there were 342 cooperative Creameries in Ohio. Grain and livestock marketing cooperatives and farm supply purchasing associations soon followed. In 1935, the Farm Bureau Rural Electrification cooperative was organized. Thirty Ohio REC's were organized and five million dollars of the first five and one-half million REA loaned to co-ops went to Ohio.<sup>1/</sup>

There have, of course, been vast changes in the economy since those days and successful cooperatives has changed with the times.

Today's cooperatives perform a massive array of tasks for their members. They market about a fourth of U.S. farm products and help farmers obtain about a fifth of their supplies. And members add to their incomes and reduce their costs by use of this business tool. Other services cooperatives provide range from artificial breeding, soil testing, and spraying on the farm

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<sup>1/</sup> Country Living Magazine, July, 1975.

to irrigation and insurance. Rural credit unions and rural telephone and rural electric cooperatives have helped farmers improve their standard of living.

To accomplish these tasks, many small cooperatives have merged into larger local cooperatives to serve more members as community and trading areas have expanded. And many of these local cooperatives have joined together to form a federated or regional cooperative. This allows them to pool resources and volume to do a better business job for farmers. The challenge to cooperatives today is to grow fast enough to effectively serve its members.

Cooperatives are chartered under State laws (except for the Farm Credit System and Federal Savings and Loan Associations that have federal charters) and they operate under the same specific federal and State business laws and regulations as other firms. Cooperatives do have three basic principles that distinguish them from other types of corporate businesses:

1. They provide goods and services to members at cost. Savings (or net margins) above costs are returned to patrons in proportion to their use of the cooperative loss incurred are charged to members in proportion to the use the member has with the cooperative.

2. Control of the cooperative is in the hands of its members. Traditionally, cooperatives operate on a one member, one vote basis. However, about 25 percent of the States permit cooperatives to allocate votes according to the number of shares of stock a member holds or the extent of his patronage. Kentucky law permits one person in a cooperative to have 49% of the controlling votes. Ohio's non-profit corporate statute under which

REC's are incorporated stated one-member, one-vote.

3. Federal and State laws specify maximum returns that a cooperative may pay on equity capital. This is to insure that any savings or profit the cooperative has goes to the users rather than investors. Profits or savings generated by the cooperative are in fact an overcharge made to the members.

While cooperatives are organized specifically to help their members, their benefits actually are widespread. They hire employees to work in their plants thus providing additional jobs in the community. Through their services the cooperative assists farmers in securing new technology, supplies and services that have made it possible for farmers to provide food and fiber to consumers at current low prices.

The taxes cooperatives pay and the money they spend in purchasing supplies for members or equipment to use in serving members are as much a part of the national economy as the taxes and expenditures of any other business.

In short--cooperatives are truly partners in American life and all Americans benefit from them.

#### WHAT A COOPERATIVE IS --

A cooperative is a business formed by a group of people to obtain certain services for themselves more effectively or more economically than they can obtain them individually. These people own, finance, and operate the business for their mutual benefit. Often by working together through such a cooperative business member-owners obtain services not available to them otherwise.

Cooperatives perform one or more of three kinds of functions: Marketing products; purchasing supplies; and providing such services as electricity, credit, irrigation and domestic water, and artificial insemination.

In certain respects, cooperatives are organized like other businesses and operate in the same way. They usually incorporate under the laws of the State in which they have their main office. They draw up by-laws and other necessary legal papers. Members elect a board to direct and manage the firm. The board hires a manager and makes general policies. The manager runs the day-to-day business.

#### A COOPERATIVE DEFINED<sup>2/</sup>

"A cooperative is a voluntary contractual organization of persons having a mutual ownership interest in providing themselves a needed service(s) on a non-profit basis. It is usually organized as a legal entity to accomplish an economic objective through joint participation of its members. In a cooperative the investment and operational risks, benefits gained, or losses incurred are shared equitably by its members in proportion to their use of the cooperative's services. A cooperative is democratically controlled by its members on the basis of their status as member-users and not as investors in the capital structure of the cooperative."

A cooperative is not an easy solution to all economic problems. A cooperative is a business operation. It must be organized, financed, and operated just as any other business on Main Street. A co-op cannot assure that a farmer, upon joining, will immediately solve his problems; nor can a co-op guarantee to turn a marginal farm into a successful commercial operation.

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<sup>1/</sup>Cooperative Criteria, Service Report 71, Farmers Cooperative Service, February, 1965.

When a cooperative is organized and goes into business it can increase competition and improve the service of the existing businesses dealing with farmers in the area served by the new cooperative.

A member of a farmer cooperative must do business with his cooperative if he expects it to be successful. Far too often producers have used their cooperative as a dumping ground for their low quality or excess products. As a result, the cooperative has not been as successful as it could have been. Even though it may continue to operate, it cannot achieve its potential if members do not use it as fully as possible.

Cooperatives differ from investor oriented firms in many respects. For example, investor oriented forms generate a profit to encourage investors --cooperatives limit the returns to investors and return profits to members as a refund on the overcharges made during the business year. Investor-oriented firms do business with the public that for the most part are not owners of the firm. Cooperatives do business with members and return their profits to these member-customers rather than a select group of investors. Thus, many have agreed that investor owned firms have a social responsibility and therefore should return a portion of their profits to finance social benefits for those who have made this profit possible by buying goods and services from the firm. Cooperatives do not have this social responsibility since they are in business to serve members and all profits or savings generated by the cooperative belong to the members and the board of trustees of the cooperative has the responsibility to see that these overcharges are returned to the members. Cooperative members as individuals can direct their funds to the social projects of their choice. Many say that it may be illegal for cooperative trustees to use members money for social responsibility.

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# AMERICAN FORMS OF BUSINESS

## A Comparison

CHARACTERISTICS	TYPES OF BUSINESS ENTERPRISE			
	INDIVIDUAL	PARTNERSHIP	ORDINARY CORPORATION	COOPERATIVE CORPORATION
FUNCTIONS	To buy, sell or produce goods for sale or to render service to the public	Same as individual	Same as individual	To purchase supplies, market products or render needed services for owners
OBJECTIVE	Profit for the individual	Profit for the partners	Profit for the investing stockholders	Economical Co-ops and service for the owners
USERS	The public	The public	The public	Members and/or owners
OWNERSHIP AND CONTROL	The individual	The partners	The investors	Owners--usually one vote each
MANAGEMENT	The individual	The partners	Board of Directors	Board of Directors or Board of Trustees
LEGAL STATUS	Usually unincorporated	Legal agreement between associates under State law	Incorporated under State Statute	Usually incorporated under specific State statute
LIABILITY	Assets of the individual	Assets of the partners	Assets of the corporation	Assets of the corporation
RETURN ON EQUITY INVESTED	Unlimited	Unlimited	Unlimited	Limited by law 8%
WHO GETS PROFITS?	The individual	The partners	The investors	The patrons in proportion to use

REC--A TOOL OF MODERN LIVING

Agricultural cooperatives are one among many tools farmers have to assist them in efficiently producing and marketing food and fiber. The agricultural cooperative is comparable to the farm tractor--each requires skilled operators, sufficient energy to operate, good maintenance to be in top working condition, and fitted for the job.

Many of our agricultural cooperatives started about 40 years ago in the days of the "Fordson" tractor. As the demands of agriculture outgrew the capabilities of the "Fordson," cooperatives have also had to change, adjust and grow to be an effective tool for modern agriculture.

The old 1923 Fordson still has some basics found in today's modern farm tractor. They each have wheels, an engine, transmission, steering wheel, and a seat; but they are quite different as the engineers have built 1975 tractors to serve 1975 farmers. The same is true for agricultural cooperatives. We still have the same basics in our 1975 agricultural cooperatives that we had 40 years ago, but like the tractor it has been necessary for agricultural cooperatives to adjust, change and grow in order to be an effective tool for farmers. Agricultural cooperatives still maintain the basic principles of democratic control, limited interest on equity capital so the savings of the cooperative will be returned to the user rather than the investor, and operation at cost which means that they price their services and/or products competitively and at the end of the business year if the cooperative has savings, they will be refunded to those who patronize the cooperative, or if it has not charged enough margin to cover the costs of operation, the users will be asked to pay their share of the loss so that each year their cooperative breaks even.

Today's cooperatives like the tractor and other farm tools are larger and constructed to serve today's needs. As tractors took on more of the farm work, they required more fuel. As cooperatives take on more tasks and services, they require more capital.

Today's cooperatives and today's tractors require skilled operators. Each are more effective and sophisticated tools. The operators of each tool must know its capabilities and how best to employ it. The farmer must keep his tractor and cooperative in top performance condition if it is to serve him.

The operators of the cooperative--the board of trustees, the manager, and the employees--must know the capabilities and limitations of the cooperative if it is to effectively serve today's farmer. Like the tractor operator, they must be trained to perform their tasks in a responsible manner.

Some farmers may prefer to farm without their cooperative. This may be because they don't understand how they can use their cooperative. Often some farmers fail to realize that those who own the cooperative do not buy from or sell to the cooperative but use it as a tool and sell through or purchase through their cooperative.

#### COOPERATIVES HAVE REPRESENTATIVE CONTROL

The method of government of a corporation is representative and is, in many respects, analogous to the representative democracy we employ to govern our state and national government.

The governing body of all types of corporations is the board of directors or trustees. Members of the board of all types of corporations



are elected by shareholders or members and these boards in turn elect the officers of the corporation.

Boards of directors or trustees for all types of corporations are the policy determining bodies of the corporation, and also the bodies which, either generally or specifically, authorize business transactions.

Boards of directors of any corporation are, therefore, analogous to the Congress, state legislature or city council.

Theoretically, control of the investor-oriented business enterprise is in the stockholders on a capital ownership basis. As a rule, in a general corporation one vote toward the election of directors is given for each share of common or voting stock the stockholder owns. However, the various devices of holding companies, voting trusts, and the like, permit economic domination over the business by a relatively small group. For example, many Federal Savings and Loans which are cooperatives, ask their members to give a direction or employee an irrevocable proxy.

#### COOPERATIVES HAVE DEMOCRATIC CONTROL

The democratic control feature of a cooperative commonly referred to as one-member one-vote is a corporate device being used in its original form, since, historically, all members of corporations had only one vote.

Historical accounts of cooperatives report that in the late 1800's some farmers gave up control of their cooperatives and lost their investment in their cooperative when they abandoned the cooperative principle of democratic control.

It is reported that farmers were led to believe that in order to attract investments and large farmers, they needed to provide for control

of the cooperative on the basis of investment. The new firm operated for the benefit of its controlling investors not its patrons.

Most state cooperative statutes passed in the 1920's were very specific in protecting the democratic control features of agricultural cooperatives as a result of these disastrous past experiences.

The democratic control feature of a cooperative is well recognized. Some writers have used the term democracy to mean a society in which the people who compose it are their own governors, much as the policyholders of a mutual insurance company are their own insurers or members of a marketing cooperative collectively provide their own marketing facilities.

The membership of a cooperative has the responsibility to periodically check to make certain that their cooperative is still democratically controlled. The test is a simple one. Do the people (member-stockholders) rule?

When a member gives his vote to another as in the irrevocable proxy used by Savings and Loans or mutual insurance companies, this is democratic as the member made the choice of how to use his vote.

Such variations in equality of voting are but one factor to be considered in determining the cooperative character of an organization. The others are distribution of savings and limited return on equity capital. Certainly minor inequalities in control, if sanctioned by the democratic action of a majority of the membership and permitted by statute, do not prevent an organization from being a cooperative.

#### TRUSTEES HAVE DEFINITE RESPONSIBILITIES

When a member of a cooperative is elected by his fellow members to a position on the board of directors, he faces a two-fold challenge:

(1) To represent stockholders or members of the business; and (2) He is vested by law with the responsibility to reasonably conduct the affairs of the business for the welfare of the cooperative.

As a board member he has legal, general, and moral responsibilities in representing stockholders or members of the cooperative.

What does the word responsibility mean? Responsibility is the obligation of an individual to carry out assigned activities to the best of his ability.

The acceptance of an obligation by an individual to perform work when the member of the cooperative who has been elected a director accepts the position, he implies that he recognizes the responsibility of the position, the specific responsibilities set forth in the cooperative's by-laws, and agrees to discharge these responsibilities to the best of his ability.

A board of directors or trustees is the governing body of a corporation legally created under state statutes and issued a "charter." The state statutes give the board authority to exercise all the powers of the corporation, limited only by any conditions set forth in the statute and the corporation's by-laws or code of regulations.

Members of the cooperative elect a director to a position of trusteeship. In effect, they legally place their financial interests in their cooperative in the hands of the director they elect.

#### TRUSTEES REPRESENT PEOPLE, NOT DOLLARS

A cooperative trustee does not make decisions for himself but for the total membership of his cooperative. A director has the duty to vote for

the best interest of the total membership, not for his own personal interest. In this respect, his power to vote as a trustee is entirely different from that of a general corporation board member who may quite properly vote to serve his own interest as a major investor or an agent for a few major investors in the firm.

#### MEMBERS DESERVE THE TRUSTEES THEY ELECT TO THE BOARD

Members of a cooperative deserve the trustees they elect to represent them and their interest in their cooperative and, once elected, cooperative trustees deserve the support of the membership that requested that they take time from their farming operation to manage the affairs of their cooperative.

#### THE JOB OF A REC TRUSTEE IS SPECIAL

The position of trustee in a cooperative differs from that of a director of an investor-oriented business. Directors of non-cooperatives are usually the principle owners of the firm, and they may serve not only as a director of their firm but also as an executive, manager or employee.

The trustee of a REC is elected democratically without regard to his investment in the cooperative. In fact, the total investment of the president of a cooperative usually needs to be only one membership fee or one share of stock. The president of a REC is prohibited by statute and code of regulations from owning sufficient voting shares of stock to assure his re-election to the board, let alone assuring him of the presidency. The cooperative's ownership is not controlled by the board of directors as is often the case in the general corporation.

#### TRUSTEES EXERCISE FINANCIAL CONTROL

The directors of a cooperative have important financial functions. They have the responsibility of returning the net margins or assigning the losses to the patrons on a patronage basis.

Members, if they are going to control their cooperative, must provide a reasonable amount of the necessary capital.

#### TRUSTEES INFORM MEMBERS

The trustee of a REC has the responsibility of keeping membership informed as to the activities of their cooperative. This responsibility is shared, however, with members who have the responsibility of seeking out this information by reading reports and attending meetings.

The members of the cooperative are also responsible for the prudent use of information they receive about their cooperative. A cooperative gives a report of its affairs, activities, and future plans to all members. Non-cooperatives may need only to inform the major investors of the firm of the firm's activities and future plans. These major investors may all be members of the board of directors of a general corporation.

#### REC TRUSTEES ARE ALSO CO-OP MEMBERS

The trustee of a REC must recognize that, except when the board is in formal meeting, his authority is equal only to the rights and authority of any individual member of their cooperative. This applies to each trustee of a REC regardless of the position he may hold on the board.

Directors of investor-oriented firms by virtue of their ownership control of voting stock are the major owners, major decision makers, major

controllers of the firm, and personally may hold the votes necessary to back up his position.

As individuals, the members of the board of trustees of a REC have no authority to act for, or bind the corporation, unless they are duly elected or appointed to do so in a legal meeting of the board of trustees.

#### MEMBERS CONTROL COOPERATIVES

As a rule, members lose control of their cooperative because they abdicate their responsibility to participate in the democratic representative process that governs and controls their cooperative. The law provides for an annual meeting at which time the board will report to the membership on the operation of their co-op. Members have the responsibility to participate in annual and membership meetings. The term "members" is used in cooperatives to refer to holders of common voting stock.

The democratic control principle of a cooperative simply means that each person is entitled to only one or a minute number of votes. In a cooperative, people, not dollars, vote. The democratic principle of the cooperative exists because of the positive mandate of the cooperative statute which has been used for incorporation. The corporate papers of the cooperative will say one member - one vote or any other voting arrangement members have established for themselves.

If a statute contemplates one vote for each share of common stock, pure democracy and control can exist by limiting ownership of each member to only one share or by requiring all members to own an equal amount of voting shares of stock. Most local cooperatives limit each member to one vote.

It does not follow that the absence of absolute equality in voting prevents an organization from being a cooperative. There are cooperatives in which the members have democratically decided and so set forth in their corporate papers that voting privileges in their cooperative be based upon a condition such as patronage. Thus, some cooperatives not only provide for the distribution of savings on a patronage basis but also for voting and control on a patronage basis.

Thus the democratic control principle is employed in a particular cooperative as the owners democratically decide within the limits of the law under which they are incorporated and their corporate papers. It may be one-member one-vote, a limited maximum number of votes depending upon the number of shares owned, or a number of votes based on patronage. Under the Ohio Cooperative Marketing Act no member of a stock cooperative may have more than 5% of the votes.

Some statutes provide for, and some cooperatives have, outside directors who may not meet the requirements of membership--such as being a producer of agricultural products. Such positions are limited in number and designated to represent the general public.

#### COOPERATIVE EMPLOYEES HAVE A UNIQUE POSITION

A distinctive feature of the cooperative is the closer relationship between the business entity and its patrons than that characterizing other forms of business. This closer relationship between the cooperative and the patrons is governed by the provisions of the statute, articles of incorporation, by-laws and membership contract.

Cooperatives are people, people working together. Employees must not only sell goods and services by informing customer-owners of the cooperative principles but must use tact and judgement as they communicate between the co-op, its owners and the public. To many people, the cooperative is its employees.

Cooperative management must know (1) principles of cooperatives and (2) principles of management.

Cooperative employees must understand that the firm is a cooperative if:

1. Savings above the cost of doing business are returned to patrons in proportion to the use the individual patron made of his cooperative.
2. Control of the firm is in the hands of its members as individuals rather than as investors.
3. The firm limits the interest paid on equity capital.

REC trustee management and employees must understand how their cooperative meets these three principles and be able to explain this to customers.

REC trustees management and employees should have some knowledge of the law under which the cooperative is incorporated. This will give him knowledge of who is eligible for membership, opportunities and limitations of the cooperative firm.

#### REC TRUSTEES MUST BE MEMBERS

The position of REC trustee is not a full-time job, and therefore, most REC directors are fully employed in a capacity other than REC trustee. REC trustees need assistance from management in order to discharge their responsibilities with dispatch. Cooperative employees must collect data,



both pro and con, to assist trustees in making the decisions necessary for cooperatives to succeed.

The Code of Regulations will set forth the purpose and other information required by law.

The Code of Regulations are the directions or rules established by the membership for the Board to follow in managing the cooperative.

#### COOPERATIVES ARE CREATORS OF CHANGE

The cooperative trustee must always be willing to look ahead and chart a successful course for the cooperative through the uncharted sea of our future dynamic economy.

The REC trustee is the idea man. The REC manager is the doer.

#### TRUSTEES RESPONSIBILITY

It's your responsibility as a REC trustee that all trustees of your co-op are trained to discharge their responsibilities with dispatch.

Trustee training should start with a careful selecting of nominees for the position on the Board.

As REC's continue to grow and become an even greater influence in our economy, the demand will become greater for capable, farsighted and active board members to do the analyzing and planning required for the successful management of cooperatives. Trustees of successful REC's of the future must devote the necessary time away from their farm or major employment to effectively carry out their responsibility of trustee of their REC.

An REC operates within a legal framework made up of laws under which

it is incorporated (1702), articles of incorporation, Code of Regulations, and membership agreement.

The purpose of the Code of Regulations is to provide rules for the regulation of the affairs of the corporation.

The power to adopt regulations resides in the voting members and they alone have the power to adopt them.

It is advisable to make available to each member of the corporation a copy of the regulations.

Legal liabilities may result from a failure of officers and directors to observe regulations. Regulations are adopted by the voting members of an association, and they constitute instructions, rules or restrictions for the Board in the management of an association.

A Board of Trustees is a governing body legally created by the laws of the state and the corporate papers of the organization and by these legal documents the Board is given the authority to exercise the power of the corporation, limited only by conditions set forth in the corporation's Code of Regulations.

The Board of Trustees is not only charged with the responsibility for exercising all the authority of the corporation, its management, the safeguarding of its assets and the conduct of its business--the Board of Trustees is in fact the only group of persons in whom this authority is vested.

It is the abilities of the persons who make up the Board of Trustees or Board of Directors that is the real decisive factor in the growth and

and accomplishments of any organization.

It must always be remembered that the Board of Trustees decisions are group decisions. It is necessary that each director have knowledge of the corporations business, its opportunities and limitations and of conditions affecting its operation.

It is advisable that all vacancies which arise on the Board be filled promptly so that there may be at least five directors in office. The law gives the Board of Directors the responsibility that when a vacancy on the Board occurs other than by expiration of term, unless the articles or regulations otherwise provide, the remaining members of the Board, though less than a majority of the whole authorized number of trustees, by a majority vote, shall elect a director to fill the vacancy for the unexpired term.

If there are no provisions in the Articles, Regulations or By-laws for time or place of holding turstees meetings or for giving notice of such meetings, it is assumed that the requirements of the non-profit corporation law (1702) would apply which require written notice at least two days before each meeting of the Board.

The trustees of an REC are not bound to attend a certain number of meetings, yet their absence from meetings can in some cases make them personally liable by the fact that they failed to attend meetings and to devote the necessary attention and consideration to the affairs of the corporation.

Every officer, employee and agent handling funds, negotiable instruments or other property of or for the association, should execute and

deliver adequate bonds for the faithful performance of his duties and obligations.

The minutes of the association are the official records of that association and are so recognized by courts. Care should be exercised to make certain the minutes of Board meetings accurately describe Board action and policies established.

In general, it can be said that members of the Board of Trustees are individually and collectively under a continuing obligation to exercise their best judgement and apply such knowledge and experience as they have in the conduct and management of the cooperative's business.

If trustees exceed their authority, neglect their responsibilities or act in violation to the provisions of the statute, their charter, Regulations or By-laws or marketing contracts of their association, legal liability can result.

Although the trustee of a cooperative association occupies a position of trust, responsibility and liability, they are not insurers of the success of the association.

#### A REVIEW OF TRUSTEES RESPONSIBILITIES:

1. Trustees cannot abdicate their responsibility to direct.
2. Trustees are required to manage the business within the boundaries established by the statute under which the corporation is incorporated, its Charter, Articles of Incorporation, By-laws, or Regulations.
3. Trustees are responsible for securing capable, hired management and providing this hired management with long-range objectives and policies to guide them in their decision making and to delegate to hired management, authority to perform the tasks for which they have been given the responsibility.

4. Trustees are required to have knowledge of the corporations affairs sufficient to enable them to perform their duties effectively.
5. Trustees are required to act in good faith and with reasonable care and prudence in handling the affairs of the business.
6. Trustees are considered involved as representing a trusteeship to the stockholders or members.
7. Trustees must attend board meetings on a regular basis.
8. Trustees may be held financially liable for losses incurred by the corporation and in turn the membership of the corporation under specific circumstances such as gross negligence or woeful neglect of responsibilities.
9. Trustees are responsible for the adequate financing of the REC.
10. Trustees must see that only members vote at annual meetings.
11. Trustees are responsible for members receiving the facts about their co-ops, both good and bad.
12. Trustees are responsible for an annual meeting of voting members for election of trustees and consideration of reports.

Is your cooperative taking advantage of the educational programs of the Ohio Council of Farmer Cooperatives?

Who is your County Co-op Chairman?

When is the next meeting of your County Co-op Council?

When is the next co-op educational program in your county?